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ESG under the microscope

ESG is coming under intense scrutiny, but despite growing pains, the sustainability trend is unstoppable, five industry professionals tell Amy Carroll and Zak Bentley

ESG is under the microscope. Not only are stakeholders increasingly probing the veracity of claims, but some lawmakers have actively come out against the use of ESG factors in investment decision making.

Nick Grant, partner at Igneo Infrastructure Partners, however, says the stance being taken by certain US states is not necessarily detrimental to the evolution of ESG: "It is flushing out bad practices – the difference between what people say and what they do. From a long-term perspective, I don't think it is a bad thing that these big questions are being asked."

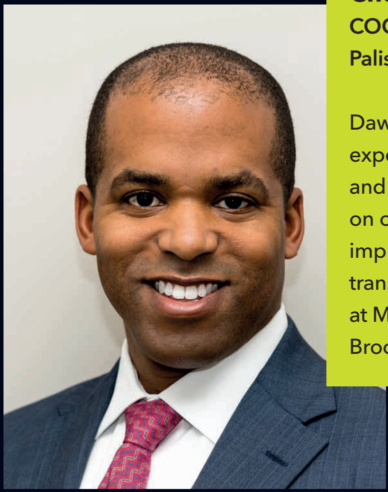
Grant adds that in Europe, attitudes to ESG have been affected by the war in Ukraine. "Prior to the Russian invasion, of the three pillars of the energy trilemma, the focus was very much on sustainability. Post-Ukraine, governments and institutions have recognised the critical importance of security of supply and affordability as well."

But despite the geopolitical backdrop on both sides of the Atlantic, ESG is only becoming more of a priority for most LPs in infrastructure funds.

"We are certainly not seeing any less commitment to ESG from investors. In fact, in some cases we are seeing investors that had not previously spent much time on this area produce lengthy ESG questionnaires," says Chester Dawes, COO and CFO at Palistar Capital.

Rosalind Smith-Maxwell, director at Quinbrook Infrastructure Partners, meanwhile, says the publicity around anti-ESG posturing in the US is overshadowing the fact that eight states have passed pro-ESG laws. "These are laws that either disincentivise investment in fossil fuel-based industries or that mandate that ESG factors be integrated into investment decision making."

"The increased frequency and severity of climate events, the need for



Chester Dawes
COO and CFO
Palistar Capital

Dawes has more than 25 years' experience in financial services and industrial companies focused on operational finance, process improvement and complex transactions. He previously worked at Manulife/John Hancock and Brookfield Asset Management.

Melisa Simic
Senior director of sustainability
Nuveen Infrastructure

Simic leads Nuveen Infrastructure's responsible investing and sustainability strategy across private infrastructure. She previously worked at APG Asset Management, ING Bank, Ramboll and ERM.

Rosalind Smith-Maxwell
Director
Quinbrook Infrastructure Partners

Smith-Maxwell has more than 15 years' experience in renewable energy and clean technology, having successfully advised on more than 4GW of renewables projects. She previously worked at Fieldstone Private Capital Group and before that Climate Change Capital.

Hasmeen Deol
Investor relations director
NextEnergy Capital

Deol joined NextEnergy Capital in 2023. She has more than 10 years' experience working in alternative investments, focusing on renewables and infrastructure. She has previously worked at Capital Dynamics, Hermes Infrastructure and Citigroup.

Nick Grant
Partner
Igneo Infrastructure Partners

Grant is head of asset management for Europe at Igneo Infrastructure Partners and sits on the boards of Coriance and Scandlines. Prior to joining Igneo in 2018, he was the CEO of Severn Trent Services in the UK, Ireland and Italy and also held senior roles at Centrica.

energy security and the political targets being set around the world all suggest there will be no reduction in commitment to sustainable investment," adds Hasmeen Deol, investor relations director at NextEnergy Capital.

"We often speak with investors that are looking to move away from managers that remain exposed to highly carbon-emitting technologies, and I have no doubt that our energy transition specialism has helped us in this challenging fundraising environment."

> *"Investors should be asking us about the biggest challenges we have faced and how we have addressed them, but the questioning is still often more superficial"*
>
> **MELISA SIMIC**
> **Nuveen Infrastructure**

Where in the world

While investor commitment to ESG and sustainability appears to be mounting, with only small pockets of dissension, the emphasis does differ significantly depending on geography.

"It very much depends on the jurisdiction and the regulation in place," says Melisa Simic, senior director of sustainability at Nuveen Infrastructure.

"Europe is leading the way with SFDR, but we are also seeing a shake-up of regulatory frameworks in Asia, including the Australian taxonomy. It is interesting, however, that the drivers behind ESG integration vary, depending on where you are in the world. A recent client survey we carried out showed that the top two reasons given for investors in EMEA were impact and investment returns, while in Asia-Pacific the focus was primarily on regulatory adherence."

Grant adds that the questions being asked also differ depending on local regulation. "We get a lot of questions about modern slavery from investors in Australia, because of the laws in place in that country. In the US, we get a lot of questions on diversity. In the EU, the focus tends to be on climate, largely due to SFDR. Regulation certainly has a big impact on LP priorities."

Despite an overarching commitment to sustainability and a broad understanding of its risk mitigation imperative, investors do still question the costs involved in ESG initiatives, however. "ESG represents a large part of investor due diligence and implementation costs are central to that," says Deol. "Our internal assessment confirms that the financial impact of implementing ESG mitigation measures on our assets is negligible on IRR. Furthermore, investors are able to look at financial returns against investment cases. If returns have exceeded expectations, then it is clear that the impact of such costs is being managed effectively."

Smith-Maxwell, meanwhile, says that auditing the working conditions of a manufacturer and getting recycling included upfront had added a de-minimis percentage to the all-in costs of a project's solar panels. "However, if we hadn't taken those steps during procurement, we would have had issues raising debt financing," she explains.

"Furthermore, for Project Gemini in America, our approach to procurement of panels, including manufacture in Mexico, enabled panels to be delivered on schedule without getting held at the border. Taking these extra steps to ensure supply-chain integrity can reduce risks and improve the delivery

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NICK GRANT
Igneo Infrastructure Partners

"In terms of sustainability, it can be hard to decide which horse to back. Which standard will ultimately be adopted, and which is best to support our ESG goals?"

CHESTER DAWES
Palistar Capital

of projects, ultimately to the benefit of investors."

Sustainability in action

Of course, sustainable investment comes in many different guises, depending on the nature of the underlying asset.

Simic, for example, highlights the importance that Nuveen Infrastructure places on engagement with local communities. She points to the firm's generational investing strategy, in particular. "When investing in solar farms, we offer farmers the opportunity to secure a dependable source of income through land leases, which protects their land from development pressures, thereby preserving the integrity of the farm for future generations."

An inclusive approach is critical. Much of the resistance to the energy transition stems from a fear of fossil fuel jobs that will be lost. "You need to bring people with you, and a focus on local job creation from new energy projects can really help with that," says Smith-Maxwell.

She adds that Quinbrook is also focusing heavily on human rights. "This is an area where we really want to direct change in the industry," Smith-Maxwell says. "We have been very selective in our sourcing of equipment and have negotiated right of audit of supply, factory visits and information rights during tendering, for example, as well as rights to terminate or claim damages if slavery issues are discovered in the manufacturing supply chain."

Grant, however, says that investors shouldn't necessarily be looking to buy the finished article. "We have an approach of improvement rather than exclusion," he says. "Some GPs and LPs don't want to be associated with hydrocarbon at all but that is just leaving the problem for someone else to resolve."

Grant points to the example of a large German utility that Igneo has acquired. "Since investing, we have accelerated the decarbonisation plans that were already in place, but some investors may not have touched that asset because at the point of acquisition a lot of the heat was still generated by coal. Reducing hydrocarbon usage is essential but requires active engagement."

Fragmented frameworks

While there are clearly myriad different approaches that investors are taking to sustainable investment, there is still sometimes a disconnect between talk and action, according to Grant. "There has been improvement but there is still an overreliance on box ticking rather than looking at what is going on within a portfolio company."

Grant concedes that SFDR is helping to clamp down on this box ticking mentality by focusing on results. "SFDR looks at the output, which is great. But there are still voluntary frameworks out there that are focused on inputs. Rewarding a company for having a health and safety policy or a diversity policy in place, for example, is pointless.

"That policy is not worth the paper it's written on because there is no guarantee that anyone in the company, other than the person who wrote it, actually knows what it says. There has been improvement but there is still too great an emphasis on reporting rather than action. That is what is behind some of the backlash that we have recently seen."

"A lot of people are still either just checking boxes or are throwing around the latest buzz words," adds Simic. "It surprises me how rarely we are interrogated on a deeper level. I think investors should be asking us about the biggest challenges we have faced and how we have addressed them, but the questioning is still often more superficial."

Part of the problem, of course, is a lack of standardisation in reporting frameworks. "Once standardisation is engrained, I would hope we would move beyond the box ticking to a real analysis of improvement in performance," says Grant. "But the focus has to be on results. It is more difficult to obfuscate when it comes to output measures than it is on input measures. SFDR is making it a lot harder to hide."

"Sustainability reporting is still relatively new and evolving rapidly, and so we have ended up with what I call the ESG alphabet soup, made up of different competing standards," says Palistar's Dawes. "Currently, in terms of sustainability, it can be hard to decide which horse to back. Which standard will ultimately be adopted, and which is best to support our ESG goals? I am an accountant by background, and we have seen the same thing play out in that profession, with the multiple GAAPs ultimately converging into an international standard plus US GAAP. I think that convergence will happen with sustainability as well, but for now, it remains a challenge."

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> **HASMEEN DEOL**
> **NextEnergy Capital**

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> **ROSALIND SMITH-MAXWELL**
> **Quinbrook Infrastructure Partners**

Smith-Maxwell says that case studies can be a useful way to cut through the confusion of conflicting frameworks. "Case studies can help bring your sustainability strategy to life. For example, we focus heavily on local procurement so when a competitive tender for our Scottish synchronous condenser came down to the final two – one a local contractor in Glasgow and another a little further afield – we made the decision to go local, thereby supporting local jobs. Another example of our approach to sustainability would be the snake boxes which are being introduced to one of our projects in Wales to benefit biodiversity."

She adds that biodiversity measurement in England is a good example of standardisation starting to make an impact. "Without that standardisation, biodiversity net gain often comes down to voluntary metrics. That is where you start to see the ghost of greenwashing or fairness-washing creeping in."

Natural capital is the new rising force within the ever-expanding world of sustainability. "With the advent of the Taskforce on Nature-related Financial Disclosures, there is going to be a lot more nature-related reporting coming down the line," says Deol. "We have been an early adopter of TNFD, and we have been working with universities and consultants to set a precedent of biodiversity metrics that governments can implement across the board in parallel to utility-scale solar assets."

Naturally, as reporting requirements proliferate, the compliance burden is increasing sharply, proving a particular challenge for smaller assets. "There are infrastructure companies out there that employ thousands of people and that have no problem meeting the requirements of their investors and of the regulator," says Igneo's Grant. "But at the same time, there are infrastructure companies that may have a large asset base, but that only have 20 or so employees. I think requirements need to be adapted to the size of the business."

Dawes agrees that a more nuanced approach is needed. "As digital infrastructure specialists, we are often grouped into general infrastructure but while general infrastructure is responsible for around 80 percent of greenhouse gas emissions, digital infrastructure is responsible for around 2 percent. Nonetheless, we are expected to conduct the same level of diligence and have the same size compliance teams as more general infrastructure investors that may own airports, roads and bridges."

Election fever

Despite these inevitable growing pains, the consensus it seems is that the sustainability trend is unassailable. But with more voters than ever going to the polls in 2024 – 64 countries representing around 49 percent of the world's population – could this global mega-trend yet be derailed?

Deol thinks not. "Support for clean energy has been prevalent across the political spectrum in most geographies. But, in any case, solar, for example, is no longer relying on government subsidies. It is a proven, stable and low-cost form of electricity."

Smith-Maxwell agrees. "There are three massive push factors behind the energy transition. Political will, societal pressure and fundamental economics."

We may be experiencing some temporary setbacks, but it is clear that the sustainability juggernaut remains unstoppable. ■